

Office of Financial Management

---

# **BEST PRACTICES AND TRENDS IN PERFORMANCE BASED CONTRACTING**

Prepared By



8201 164<sup>th</sup> Avenue NE, Suite 300  
Redmond, WA 98052  
tel: (425) 867-1802  
fax: (425) 867-1937  
[www.fcsgroup.com](http://www.fcsgroup.com)

December 14, 2005

8201 164th Ave NE, Suite 300 T: 425.867.1802  
Redmond, Washington 98052 F: 425.867.1937

50 California St, Suite 1500 T: 415.227.5905  
San Francisco, California 94111 F: 415.439.5299



December 15, 2005

Ms. Laura Nelson  
Office of Financial Management  
210 11<sup>th</sup> Ave SW Rm. 311  
Olympia, Washington 98504

**Subject: Best Practices and Trends in Performance Based Contracting**

Dear Ms. Nelson:

We are pleased to submit our final report summarizing the results of our literature search and state survey on the best practices and trends in performance based contracting. We have enclosed ten report copies for your use and will send you an electronic copy via e-mail. If you are interested in any of the articles or documents, please let me know, and depending on the source of the article, we can send you a copy, if allowed.

We will be using information in this report to prepare for our training session, and we also plan to discuss with you our ideas and get your input on topics for the training session. If there are any questions, please do not hesitate to contact us (425) 867-1802 ext. 228.

Very truly yours,

Peter Moy  
Senior Project Manager

Enclosures

## TABLE OF CONTENTS

<b>I.</b>	<b>Introduction.....</b>	<b>2</b>
<b>II.</b>	<b>What is Performance Based Contracting .....</b>	<b>4</b>
<b>III.</b>	<b>Expectations of Performance Based Contracting.....</b>	<b>5</b>
<b>IV.</b>	<b>The Contract Management Process .....</b>	<b>6</b>
<b>V.</b>	<b>Implementation Issues.....</b>	<b>11</b>
<b>VI.</b>	<b>State Survey.....</b>	<b>13</b>
<b>VII.</b>	<b>Recommendations for Washington State .....</b>	<b>15</b>

### **Appendices**

Bibliography .....	Appendix A
Survey Responses .....	Appendix B

## I. INTRODUCTION

According to the Office of Financial Management (OFM), performance based service contracting has been a key topic of interest for state agencies in recent years. OFM believes that as agencies work to contract for results instead of merely buying services, performance based contracting will become an important tool to assure that the State's taxpayers are receiving the best value for the services purchased. To assist OFM and state agencies understand the best practices and trends in performance based service contracting, OFM included research on performance based contracting as part of its scope of work for auditing personal and client service contracts.

To identify best practices and trends, FCS Group conducted a literature search and contacted several agencies in other states and local jurisdictions that have implemented performance based contracting. The literature search involved searching the internet and using library data bases from the University of Washington and the King County Library District. Over 40 related articles and documents concerning performance based contracting were reviewed. A bibliography is in Appendix A. Based on the literature review, FCS Group also contacted agencies in New York City, in San Diego County, and in the states of Wisconsin, Arizona, Minnesota, and Illinois.

As part of identifying the best practices and trends, the literature review and the survey of other states and jurisdictions focused on the following key issues:

- What is performance based contracting?
- What are the expectations of performance based contracting?
- What is the contract management process for performance based contracts?
- What implementation issues and barriers must be addressed to assure that performance based contracting is successful?

The concept of performance based contracting (PBC) began in 1991 when the Office of Federal Procurement Policy in the Office of Management and Budget issued Policy Letter 91-2 on service contracting that emphasized the use of performance requirements and quality standards in defining contract requirements, source selection, and quality assurance. In 1997 the requirement was incorporated into the Federal Acquisition Regulations. The federal government has been increasing the emphasis on performance based contracting, and by 2005, it is expected that agencies will apply performance based contracting to 50% of their eligible service contracts.

In addition to the federal government's change in procurement policies, other legislation and guidelines were adopted that focused on performance. Congress passed the Government Performance and Results Act of 1993, and the Governmental Accounting Standards Board initiated a service efforts and accomplishments reporting effort in 1994. Like the federal government, states have also been increasing their emphasis on performance based contracting. Many states and other jurisdictions began their efforts, primarily in human services, in the mid to late 1990's, and some states have even mandated such contracting. Examples of state actions to implement performance based contracting include the following:

- The Florida legislature passed legislation in 1994 requiring implementation of performance based contracting for all state funded programs. The Department of Children and Families was under a mandate to contract out all department services by the end of 2004 and its strategy for accomplishing this mandate was to adopt the use of performance based contracting,
- The Maine legislature passed legislation in 1994 requiring that after July 1, 1997 human service contracts awarded by the Maine Department of Human Services had to be performance based,
- The Kansas Department of Social and Rehabilitation Services initiated performance based contracting in 1997,
- In New Mexico's General Appropriation Act of 2000 for the Department of Health, appropriations were contingent on the department including performance measures in its contracts,
- The Oklahoma Department of Rehabilitation Services began its performance contracting system in 1992, and
- The Illinois Department of Children and Family Services began performance contracting in 1997 to improve its performance in finding permanent homes for children in foster care.

Other states where performance based contracting has been initiated and discussed in the literature include the following:

- Minnesota Department of Human Services Refugee Services Section,
- Pennsylvania Department of Welfare,
- Arizona Department of Economic Security,
- North Carolina Division of Social Services,
- Wisconsin Department of Public Health,
- Massachusetts Department of Social Services, and
- Oregon Housing and Community Services Department

The Washington State Lottery is also mentioned in the literature. In the article, "Making Performance-Based Contracting Perform: What the Federal Government Can Learn From State and Local Governments", the Washington State Lottery was used as an example of performance based contracting for revenue enhancement. The Lottery tied its advertising company's fee to lottery sales. The fee paid could range between 90 and 115 percent of a base fee depending if lottery sales were lower or higher than a specified benchmark amount.

## II. WHAT IS PERFORMANCE BASED CONTRACTING?

Performance based contracting has several characteristics that distinguish it from the more traditional types of governmental contracting. Performance based contracting typically incorporates some or all of the following:

- Emphasizes results related to output, quality, and outcomes rather than how the work is performed,
- Has an outcome orientation and clearly defined objectives and timeframes,
- Uses measurable performance standards and quality assurance plans, and
- Provides performance incentives and ties payment to outcomes.

According to the literature, the federal government has very specific performance based contracting guidelines that include all of the above characteristics as delineated by the Office of Federal Procurement Policy and the Federal Acquisition Regulations. Not all of these specific characteristics are included by state and local agencies implementing performance based contracting, but all agencies do include an emphasis on contractor performance that is related to desired agency outputs and outcomes for the services provided. Among the states there can also be different methods of implementing performance based contracting. An article analyzing performance contracting in six states found that performance based contracting varied in six states based on the following:

- The amount and timing of payments,
- The extent to which incentives or disincentives were offered,
- The frequency of contractor reports on performance, and
- The extent that contractors were involved in developing the performance indicators.

Performance based contracting is being used for a variety of types of services that are provided to or used by public agencies at the federal, state, and local levels. Examples of the types of services that are being procured through performance based contracting include the following:

- Information technology and systems
- Janitorial services
- Building maintenance
- Landscaping and maintenance services
- Health services,
- Employment services
- Child welfare services
- Corrections services
- Design and construction services
- Educational services
- Firearms support services
- Food management
- Refuse collection and recycling

### **III. EXPECTATIONS OF PERFORMANCE BASED CONTRACTING**

Because the intent is to pay contractors based on outcomes and performance rather than the processes or methods used to deliver goods and services, the literature has identified many positive expectations and benefits often associated with performance based contracting. The following is a list of such expectations and benefits that may occur as identified in the literature.

#### **Performance and Cost Expectations and Benefits**

- Encourages and promotes contractors to be innovative and find cost effective ways of delivering services,
- Results in better prices and performance,
- Maximizes competition and innovation,
- Lowers ongoing expenses,
- Achieves cost savings,
- Expects contractors to control costs,
- Creates better competition,
- Creates better value and enhanced performance,
- Gives the contractor more flexibility in general to achieve the desired results,
- Shifts risk to contractors so they are responsible for achieving the objectives,
- Provides incentives to improve contractor performance and ties contractor compensation to achievement,
- Provides financial incentives for efficient use of resources,
- Increases the likelihood of meeting mission needs,
- Shows results more quickly,
- Promises better outcomes, and
- Rewards good performance.

#### **Partnership Expectations and Benefits**

- Encourages contractors and governments to work together to provide the best services to clients, and
- Allows contractors to have buy in and shared interests.

#### **Agency Expectations and Benefits**

- Promotes the achievement of departmental outcomes,
- Identifies priority areas and invest resources to maximize client outcomes,
- Sets groundwork to evaluate programs and services, and
- Documents results for the federal Government Performance and Reporting Act. (States can benefit from a review of federal results.)

#### **Contract Administration Expectations and Benefits**

- Requires less day-to-day monitoring,
- Results in more economical procurement and contract administration,
- Minimizes reporting requirements, and
- Requires less frequent but more meaningful monitoring.

In terms of performance, studies evaluating performance based contracting discuss how several agencies have experienced improved performance. Examples include the following:

- The Oklahoma Community Rehabilitation Services Unit found that contractors' costs per placement declined 51 % between 1992 and 1997, that the average number of months that clients spent on waiting lists decreased by 53%, that the average number of weeks spent in assessment declined 18%, and that the number of persons who never got a job decreased by 25%.
- The North Carolina Division of Social Services increased the number of adoptions from 261 adoptions in FY 1993-1994 to 364 FY 1995-1996 and to 631 in FY 1997-1998.
- The Illinois Department of Children and Family Services increased the number of placements in its Relative Home Care caseload from 2,411 to 5,570 in its first year, and in the second year the placements reached 9,503. As a result the Relative Home Care caseload declined by 41%.
- Minnesota's Department of Human Services increased job placements from 591 in 1995 to 1,423 in 1999.

#### **IV. THE CONTRACT MANAGEMENT PROCESS**

Most of the literature on the contract management process relates to the federal guidelines established by the Office of Federal Procurement Policy. The Office issued a 1998 Guide to Best Practices for Performance Based Service Contracting, and in 2004 the Office replaced the 1998 guide with the Seven Steps to Performance Based Service Acquisition.

Despite differences in the federal and state perspectives, the Seven Steps to Performance Based Service Acquisition does provide an overview of the contracting process. The guide also explains a number of elements that accompany each step. The seven steps and their elements are the following:

1. Establish an integrated solutions team
  - Ensure senior management involvement and support,
  - Tap multi-disciplinary expertise,
  - Define roles and responsibilities,
  - Develop rules of conduct,
  - Empower team members,
  - Identify stakeholders and nurture consensus, develop and maintain the knowledge base over the project life, and establish a link between program mission and team members' performance.
2. Describe the problem that needs to be solved
  - Link acquisition to mission and performance objectives,
  - Define desired results at a high level,
  - Decide what constitutes success, and



- Determine the current level of performance.
3. Examine the private sector and public sector solutions
    - Take a team approach to market research,
    - Spend time learning from public sector counterparts,
    - Talk to private sector companies before structuring the acquisition,
    - Consider one-on-one meetings with industry,
    - Look at existing contracts, and
    - Document market research.
  4. Develop a performance work statement or statement of objectives,
    - For a performance work statement
      - Conduct an analysis of work to be performed,
      - Apply the “so what?” test,
      - Capture the results of the analysis in a matrix,
      - Write the performance work statement, and
      - Let the contractor solve the problem, including the labor mix.
    - For a statement of objectives
      - Begin with the acquisition’s “elevator message” (a statement of how the contract relates to the agency’s program or mission need and what problem needs solving),
      - Describe the scope,
      - Write the performance objectives into the statement,
      - Make sure the government and contractors share objectives,
      - Identify the constraints,
      - Develop the background, and
      - Make the final checks and maintain perspective.
  5. Decide how to measure and manage performance,
    - Review the success determinants (i.e. Where do you want to go and how will you know when you get there),
    - Rely on commercial quality standards, if applicable,
    - Have the contractor propose the metrics and the quality assurance plan,
    - Select only a few meaningful measures on which to judge success,
    - Include contractual language for negotiated changes to the metrics and measures,
    - Apply the contract type order of precedence carefully,
    - Use incentive type contracts,
    - Consider “award term” (i.e. ties the length of contract to the performance),
    - Consider other incentive tools,
    - Recognize the power of profit as motivator, and
    - Most importantly, consider the relationship.
  6. Select the right contractor
    - Compete the solution,
    - Use downselection and “due diligence”,
    - Use oral presentation and other opportunities to communicate,

- Emphasize past performance in evaluation,
- Use best value evaluation and source selections, and
- Assess solutions for issues of conflict of interest.

7. Manage performance

- Keep the team together,
- Adjust roles and responsibilities,
- Assign accountability for managing contract performance,
- Add the contractor to the team at a formal kick-off meeting,
- Regularly review performance in a contract performance improvement working group,
- Ask the right questions, and
- Report on the contractor's past performance.

Besides the above guidelines, the Federal Acquisition Regulations also define the elements of performance based contracting. Federal Acquisition Regulation 37.6 – Performance Based Contracting defines the elements as the following:

- Statement of work – Defines requirements in clear, concise language identifying specific work to be accomplished, tailored to consider the period of performance, deliverable items, and desired degree of performance flexibility. Describes the work in terms of what is to be required output rather than how the work is to be completed or the number of hours to be provided, enable assessment of work performance against measurable performance standards, rely on the use of measurable performance and financial incentives in a competitive environment to encourage competitors to develop and institute innovative and cost effective methods of performing the work, and avoid combining requirements into a single acquisition that is too broad for the agency or prospective contractor to manage effectively.
- Quality assurance plan - Recognizes the responsibility of the contractor to carry out its quality control obligations and contains measurable inspection and acceptance criteria corresponding to performance standards. Focuses on the level of performance required rather than the methodology used to achieve the level of performance.
- Selection procedures - Uses competitive negotiations when appropriate to ensure selection of services that offer the best value.
- Contract type - Uses the contract type to motivate contractors to perform at optimal levels. To the maximum extent practicable, performance incentives shall be incorporated into the contract to encourage efficiency and to maximize performance. Incentives should correspond to specific performance standards. Fixed price contracts are generally appropriate for services that can be defined objectively and for which the risk of performance is manageable.
- Follow-on and repetitive requirements - Relies on experience gained from prior contract to incorporate performance based contracting methods.

Although states have initiated efforts regarding performance based contracting, there does not seem to be a standardized format or guide such as the ones that exist for federal agencies. The literature primarily focuses on what states have done, whether performance has improved, what problems they encountered, and what are key elements for successfully implementing performance based contracting. One article, “Making Performance-Based Contracting Perform: What the Federal Government Can Learn From State and Local Governments”, discusses the differences between the federal and state efforts as of 2002 before the Seven Steps to Performance Based Service Acquisition guidelines were developed.

The article identified four problems with the federal perspective:

- Definitional confusion where various departments and regulations cause different interpretations of how performance based contracting is defined,
- Failure to link performance based contracting more closely with Government Performance and Results Act,
- A one size fits all approach (e.g. the Office of Federal Procurement Policy has determined the only approach), and
- A preference for design considerations (e.g. how to) over performance considerations.

Based on the article’s research on the experiences of state and local governments, the following lesson’s learned were identified in the article.

- Performance based contracting at the state and local levels differs considerably from what is generally recognized as PBC under federal guidelines,
- Performance based contracting at the state and local levels defines “performance” as consisting of outputs, quality, outcomes, or any combinations,
- Performance based contracting at the state and local levels involves varying degrees of being performance based,
- Performance based contracting at the state and local levels challenges the notion that there is one best way to do performance based contracting,
- Performance based contracting at the state and local levels includes share-in-savings contracting, revenue enhancement contracting, and milestone contracting,
- Performance based contracting at the state and local levels makes frequent use of incentives and penalties regardless of mission criticality or the dollar value of the contract,
- The manipulation of workload can change the behavior of contractors to focus more on performance, exclusive of other performance based contracting considerations,
- The adoption of “floating” incentives and penalties is a useful approach when a performance based contract contains numerous important performance requirements,

- Third party certification is a low cost and highly reliable approach to quality assurance and monitoring,
- The step-up/step-down method is a useful approach to structuring incentives and penalties, and
- Contracting for non-specific performance is a creative approach to structuring performance based contracts that may be useful in at least some situations.

Where the federal guidelines identify specific steps in the performance based contracting process, the literature regarding the state and local contract management processes and efforts identifies more specific actions or issues that can be taken to improve performance based contracting efforts within an agency. Some of these actions are also addressed specifically by the federal guidelines in its seven steps.

The private sector has also contributed to the discussion on performance based contracting. In a white paper, “Facilitating the adoption of Performance Based Service Contracting in government agencies/organizations”, Hewlett Packard Development Company LP discussed its concepts on what were the typical elements of a performance based contract. The previous article mentioned the definitional confusion within the federal agencies, and this private sector paper also adds different definitions and terms used in the private sector regarding performance based contracting. The paper identified the following contracting elements.

- Terms and conditions,
- Detailed statement of work, including service level boundaries,
- Service level objectives, with measurable and contractual performance metrics,
- Incident management and resolution,
- Program management office/customer management office, including comprehensive governance structure,
- Service provider and agency roles and responsibilities,
- Change management process,
- Transition/transformation management,
- Service fee schedule, and
- Performance based incentives and penalties.

Based on the company’s experience working with private and public clients, it discussed the following three elements that are especially critical to success in performance based contracting.

- Service level objectives establish performance based contractual and measurable metrics in areas that impact agency objectives and customers the most.
- Service level management helps ensure the reality of effective service delivery, and

- Governance is a formal management framework and structure that enables the service providers and agencies to mutually manage the relationship, as well as its expectations, contractual dependencies, and services.

The following section addresses the problems and barriers that agencies have encountered in implementing performance based contracting as well as the opportunities to improve the process and results.

## **V. IMPLEMENTATION ISSUES**

Many articles and other documents concerning implementation of performance based contracting identified a variety of issues and problems that occurred when agencies started to use performance based contracting. The issues and problems identified in the various articles and documents can be divided into three types: those affecting contractors and agencies, those affecting only contractors, and those affecting only contracting agencies.

For both contractors and agencies, the following were identified as issues and problems:

- The newness and difficulty of measuring outcomes,
- The fear of change and lack of understanding of performance based contracting,
- The perception that performance measures are difficult to understand and complicated to implement,
- Data can not be gathered and interpreted without good management information systems, and
- The shift of changing emphasis from processes to outputs.

For the contractors, the following were identified as issues and problems:

- Contractors lack knowledge of performance based contracting,
- Performance requirements may be contingent on factors outside of the contractor's control,
- Contractors may have limited financial resources and capacity to assume risk,
- Contractors fear a cash flow crisis and financial uncertainty,
- Contractors fear letting go of a system they know,
- Contractors need to be given the opportunity to provide input in developing performance measures,
- Contractors may have underdeveloped client and financial information management systems,
- Contractors need assurance that it is a collaborative process,
- Success depends on buy in from contractors,
- The anticipated risk or effort for contractors exceeds their return, and
- Multiple and even conflicting requirements may exist if a contractor has multiple contracts.

For contracting agencies, the following were identified as issues and problems:

- Performance measures must be balanced with state and federal mandate requirements that are still compliance based,
- Internal barriers are more focused on hard dollars and control, cycle time, and staff time required on front end, no authority to use RFPs, and difficulty in quantifying outcomes,
- External barriers include few or no potential providers of the services or goods and the ability of the particular industry to respond effectively is limited,
- A number of internal department problems and opposition had to be overcome and leadership had to be willing to take on state and federal bureaucracies,
- There is inadequate staff training,
- There can be incentives for contractors to service the easiest clients,
- There is a real impact on staff time and dollars,
- What enforcement is done for poor performance, and
- Agencies fear that performance based contracting takes more time than traditional contracting.

Based on the above issues and problems identified in the various articles and documents, there are a number of critical success factors that seem to determine how successful performance based contracting is implemented. These critical success factors appear to be the following:

- Partnership and teamwork – A number of different individuals and organizations are involved in performance based contracting, and such contracting means a change in the business relationships that contractors and state agencies have had for many years. There are the contractors, the agency program staff, the procurement and contracts staff, and agency management. Collaborative relationships need to be formed between the agency staff and the contractors as well as among the agency staff, the procurement and contracts staff, and management. Trust, open communication, and strong leadership are mentioned in several articles and documents.
- Staff and contractor training – Staff and contractor training were often mentioned as critical to successful implementation. The types of training include establishing performance measures and preparing various contract provisions, such as the statement of work or objectives, the contract payment process, incentives and penalties, and a monitoring or quality assurance plan.
- Planning – Conducting sufficient planning before implementing performance based contracting is also an important element. Planning efforts involve establishing who should be involved, identifying performance measures and desired outcomes in tandem with contractors and vendors, determining the current performance level, identifying potential risks, evaluating what services and programs will benefit the most from performance based contracting, and developing an implementation plan. A key indicator of agency planning is whether the agency already has a strategic plan and has established performance measures for its various programs.

- Internal management systems – Keys to measuring and monitoring performance are the internal management support systems for both the agency and the contractors. Management information systems that can provide data to support performance and outcome measures as well as a monitoring plan are critical.

The above implementation issues and critical success factors need to be considered by Washington State agencies if performance based contracting is to be successfully implemented.

## **VI. STATE SURVEY**

As part of the research on performance based contracting, a number of state and local agencies were contacted about performance based contracting. The selected agencies were based on the literature review, and agencies were selected to obtain a mix of services as well as type of government. The selected agencies included the Illinois Department of Children and Family Services, the Arizona Department of Economic Security, the Wisconsin Division of Public Health, Minnesota Department of Human Services, San Diego County's Department of Health and Human Services, and New York City. A number of questions were sent to each agency and jurisdiction, and the following summarizes the responses in Appendix B.

- Three of the four states changed to performance based contracting to achieve better results.
- Implementation of performance based contracting ranges from statewide, agency wide, to only within specific agency divisions or programs.
- Impacts in each state agency vary, but include increased accountability for service delivery and deliverables, the partnership between the contractor community and the state agency, dramatic reductions in the number of children in substitute care and shorter lengths of stay, and identification of specific products versus activities that don't show results.
- State agencies have defined performance as deliverables, outputs, outcomes, and effectiveness and efficiency.
- Critical processes that made for successful implementation included holding partnering meetings with the contractor community to identify performance measures, having regularly scheduled meetings with all contractors once the contracts were awarded, identifying and discussing risks, making agreements to reinvest some savings back into the system, having a formal contract review and approval process located in one division, providing staff training, and maintaining open communication.
- Specific types of problems that the state agencies encountered included defining and identifying performance measures, providing adequate staff training, changing from budget based contracts to rate based contracts with deliverables or outcomes as the trigger for payment, dealing with cash flow issues when payments are based on deliverables or outcomes, dealing with contractors to resolve problems, having

agencies do what they should be doing because there were certain elements in the process that contractors do not control, having data for performance monitoring, and getting staff to switch their thinking from activities to outcomes.

- According to the state agencies, both staff and contractors generally accepted the change to performance based contracting, but initially there was difficulty accepting the change. In one state agency, staff are still resistant sometimes.
- If a contractor does not meet the performance criteria, state agencies have different ways of handling the problem. One state agency sends a non-compliance letter but there is no payment penalty. In contrast, another state agency actually takes funds back. For the other two state agencies, non-performance can affect the contract size for the next year, the number of referrals for intake, the payment levels, and continuation of the contract.
- To maintain and improve their performance based contracting efforts, the four state agencies are emphasizing different areas. Arizona's Department of Economic Security is continuing meetings with the contractor community and holding regular meetings to discuss service delivery and achievement of outcome goals. In Illinois, the Department of Children and Family Services is shifting the focus to address practice and service delivery issues in areas that need improvement as identified in a review by the agency. In Minnesota's Department of Human Services, training is still given to staff to stress the importance of including measurable outcomes in both the solicitation and the contract documents and to provide training on contract management. In Wisconsin's Division of Public Health, the agency is identifying different ways to deal with performance because funding reductions are so controversial.

The local agencies also had similar responses, and some of their key responses were the following:

- San Diego's Department of Health and Human Services has moved 20% of its cost reimbursement contracts to performance based contracts.
- New York City has seen an increase in quantity as well as in the quality of contractor output.
- Although performance based contracting is encouraged and is preferred, it is used where appropriate, and agencies have the discretion on whether to use it or not.
- Key issues for San Diego's implementation were staff and contractor training, and a willingness to accept a new contracting method, while for New York City, a key issue was whether the contractors had the internal capacity for accounting, client tracking, and other management systems.
- In San Diego, performance based contracting has received mixed reactions, but overall they have been positive. In New York City, it has been a learning process for both City



agencies and the contractor community, particularly human service providers who had historically been paid based on line item budget reimbursement.

- When contractors do not meet performance criteria, both jurisdictions may require contractors to submit improvement or corrective action plans or may terminate the contract.

Based on the responses from the four states and the two local jurisdictions, performance based contracting has generally been a positive experience with some mixed reactions. The key issues and critical success factors are consistent with those in the literature as discussed previously. While they have all implemented performance based contracting, the extent of the implementation and the challenges they face varies for each jurisdiction.

## **VII. RECOMMENDATIONS FOR WASHINGTON STATE**

Based on the results in other states and jurisdictions, Washington State agencies should consider using more performance based contracting, where appropriate. There are, however, a number of past contracting issues that could affect the State's success in implementing performance based contracting. The Task Force on Agency Vendor Contracting Practices identified several findings in its 1999 Report on Social Service Contracting Practices, and many of these findings are related to implementation issues regarding performance based contracting. The following findings in the Task Force's review of social service contracting practices seem relevant to the State's ability to address the implementation issues:

- There is a need to improve selection methods in award of social service contracts. There sometimes is a lack of adequate analysis of contractor past performance and other relevant factors to ensure award of contracts to capable, responsible contractors.
- Social service contracts often lack adequate accountability expectations in their statements of work including effective measures of accountability, quality and performance.
- State agencies are often not aware of all funding sources used by the contractor to deliver social services. This prevents a clear understanding of who is paying for what and leads to financial compliance problems.
- State agencies generally are not provided adequate resources for effective contract management and monitoring. More priority needs to be given to the development of adequate systems and resources. Contract management and monitoring of social service contracts should be based on risk assessment criteria.
- Monitoring efforts are generally not adequately coordinated within and among agencies, thereby depriving staff of opportunities to detect duplication of services and to implement monitoring efficiencies.

- The state does not have guidelines for social service contract administration. This results in inconsistent contract management and monitoring and confusion for contractors.
- The state lacks adequate training and other resource materials for staff on how to effectively administer and monitor social service contracts.
- Initial communication of contract requirements and expectations to nonprofit contractors is not always adequate to prevent misunderstandings and ensure that requirements are fully met.
- The state does not always approach its contracting relationship with its contractors as a coordinated effort to provide quality services to its clients. Communication between the state agencies and contractors needs to be further developed.

A number of these 1999 findings are directly related to the critical success factors identified in the literature, and the Office of Financial Management should determine the current status of these issues before working with agencies to begin implementing more performance based contracts. In addition, the current Office of Financial Management guides on client and personal service contracting include only brief sections on performance measures and outcomes and performance based contracts. More information in the guidelines and training is needed. Should funding and resources become available, OFM could take the following types of actions to strengthen performance based contracting in Washington state.

- Identify which agencies are currently using performance based contracts and determine what success they have had,
- Develop top management level support among state agencies for implementing more performance based contracting,
- Identify the most appropriate services to begin the process of implementing performance based contracting on a more widespread basis and develop an implementation plan with the participating agencies. OFM should develop criteria consistent with the critical success factors to determine which agencies are better prepared to implement performance based contracting.
- Provide OFM technical support through staff and revisions to the OFM client service and personal service guides to help provide more information and guidance on performance based contracting, and
- Develop a monitoring plan to evaluate the impact that performance based contracting has on participating agency services and outcomes.

## **APPENDIX A BIBLIOGRAPHY**

Brown, Edward A. "Applying the Principles of the Government Performance and Results Act to the Research and Development Function." The Army Research Laboratory (1996)

Chapin, John and Fetter, Bruce. "Performance-Based Contracting in Wisconsin Public Health: Transforming State-Local Relations." The Milbank Quarterly 80.1 (2002): 97-124.

Cooper, David. "Performance Based Contracting Produces Favorable Outcomes." Hazardous Waste Superfund Week 24.42 2002): NA.

Department of Transportation. "Frequently Asked Questions of Performance Based Service Contracting." <<http://www.dot.gov/ost/m60/pbsc/frequestion.htm>>

Florida State University Purchasing Department. Performance Based Contracting Presentation. <<http://www.purchasing.fsu.edu/PBC%20presentation%202.ppt>>

Gordon, Stephen B. Performance Based Standards in Contracting Presentation. March 26, 2004

Government Resources Page/Performance Based Contracting. Women Owned.com 11 Oct. 2005. < <http://www.womanowned.com/Growing/GovResources/Performance.aspx>>

Hardy, Michael. "Training Gives IRS and Edge on Performance-Based Contracting." Federal Computer Week 19.22 (2005): 49.

Hewlett Packard. "Facilitating the Adoption of Performance Based Service Contracting in Government Agencies/Organizations." (2004)

Huyser, Kevin J. "Performance-Based Service Contracting: New Rules on Performance Based Service Contracting." The Army Lawyer (2003): 187-188.

ICMA. Performance Based Contracting. IQ Report. Volume 33/Number 6 June 2001.

Interagency Task Force on Performance-Based Service Acquisition. "Performance-Based Service Acquisition." (July 2003) Washington, DC.

Leef, George C. "Making the Grade: Fundamentals in Performance Based Contracting." Mackinac Center for Public Policy. September 1, 1997.

Markus, Edward. "Low Bid Alternatives." American City & County 1 Aug 1997. <[http://americancityandcounty.com/mag/government\\_low\\_bid\\_alternatives/index.html](http://americancityandcounty.com/mag/government_low_bid_alternatives/index.html)>

Martin, Lawrence L. "Performance Based Contracting for Human Services: Does It Work?" Administration in Social Work 29.1 (2005): 63-77.

Martin, Lawrence L. "Performance-Based Contracting in Wisconsin Public Health: Transforming State-Local Relations." The Milbank Quarterly 80.1 (2002): 97-124.

## **APPENDIX A BIBLIOGRAPHY**

Martin, Lawrence L. "Making Performance-Based Contracting Perform: What the Federal Government Can Learn from State and Local Governments." Washington, DC: The PricewaterhouseCoopers Endowment for the Business of Government.

<[http://www.endowment.pwcglobal.com/publications\\_grantreports.asp](http://www.endowment.pwcglobal.com/publications_grantreports.asp)>

Martin, Lawrence L. "Performance-Based Contracting (PBC) for Human Services: A Review of the Literature." Center for Community Partnerships. December 2003.

<<http://www.centralfloridapartnershipcenter.org>>

Martin, Lawrence L. "Performance Contracting in the Human Services: An Analysis of Selected State Practices." *Administration in Social Work* 24.2 (2000): 29-44.

McDonald, Jess. Testimony before the Government Management, Information and Technology Sub-Committee of the House Committee on Government Reform: Illinois; Performance Contracting in Child Welfare. (2000) 11 Oct. 2005.

<<http://www.state.il.us/DCFS/docs/testimony.shtml>>

Neighborhood Employment Network. Performance Based Contracting Evaluation Project. September 2003.

New Mexico Department of Health. (2004). Performance Contract Management – Report to the Legislative Finance Committee. New Mexico: Author.

New Mexico. Performance Contracting Act. (2005).

<<http://hed.state.nm.us/CIP/..%5CBills%5CBills2005%5CHB283-950%20Feb%203.pdf>>

Office of Federal Procurement Policy. "A Guide to Best Practices for Performance-Based Service Contracting." Washington, D.C.: Author.

<<http://www.arnet.gov/Library/OFPP/PolicyDocs>>

Office of Inspector General. "EPA Could Increase Savings and Improve Quality Through Greater Use of Performance-Based Service Contracts." Washington, D.C.: Author.

<[http://www.epa.gov/oig/reports/2003/PBSC\\_Final\\_Audit\\_Report20030331.pdf](http://www.epa.gov/oig/reports/2003/PBSC_Final_Audit_Report20030331.pdf)>

Office of Federal Procurement Policy. "Seven Steps to Performance-Based Service Acquisition." Washington, D.C.

<<http://www.acqnet.gov/Library/OFPP/BestPractices/pbsc>>

Office of Management and Budget. "Memorandum dated August 8, 1997 for Agency Senior Procurement Executives, The Deputy Under Secretary of Defense (Acquisition Reform), Performance-Based Service Contracting (PBSC) Points of Contact, Subject: PBSC Checklist." Washington, D.C. Author. <<http://www.arnet.gov/Library/OFPP/PolicyDocs/pbscckls.html>>

Pellegrino, Jack. "Performance Based Service Contracting Presentation." December 2004

## APPENDIX A BIBLIOGRAPHY

Petersohn, Henry. "Performance-Based Service Contracting for Information Technology Requirements." Contract Management (April 2003) 26-36.

Professional Services Council, "Performance Based Contracting Discussion Paper."  
<<http://www.pscouncil.org/policy/performancebased.asp>>

Reed, JamesEtta E. and Jakopic, Julie N. "Through the Looking Glass: The Journey to Performance Contracting." <<http://www.nascsp.org/downloads/lkgglass.pdf>>

Reynolds, William E. "Performance Based Contracting the USAID Experience." Contract Management (December 2002) 40-47.

Richardson, John. "Making the Change to Performance-Based Service Contracting." Contract Management (April 2001). 34-50.

Robinson, Brian. "5 Keys to Performance-Based Contracting." Federal Computer Week (2005):  
<<http://www.fcw.com/print.asp>>

Rogin, Ronne A. "Performance-Based Service Contracting." Office of the Procurement Executive. (2002)  
<<http://www.ustreas.gov/offices/management/dcfo/procurement/training/pbsc1.pdf#search='performance%20based%20contracting'>>.

Sanchez, Ernest. "Performance-Based Service Contracting: A Challenge." Contract Management (February 2004) 56-57.

Schambach, Pat and Duke, Elaine. "Making Performance-Based Contracting (and Relationships) Work." The Public Manager (2004): 7-10.

Shen, Yujing. "Selection Incentives in a Performance-Based Contracting System." HSR 38.2 (2003): 535-552.

Smith, Dennis C. and Grinker, William J. "The Promise and Pitfalls of Performance-Based Contracting." Seedco. June 2004.  
<[http://www.seedco.org/publications/publications/promise\\_and\\_pitfalls.pdf](http://www.seedco.org/publications/publications/promise_and_pitfalls.pdf)>

"SO71 Increases the Use of Performance-Based Contracting." California Performance Review. 11 Oct. 2005. <<http://cpr.ca.gov/report/cprprt/issrec/stops/proc/so71.htm>>

United States General Accounting Office. Report to the Chairman, Subcommittee on Technology and Procurement Policy, Committee on Government Reform, House of Representatives; Contract Management: Guidance Needed for Using Performance-Based Service Contracting. September 2002. <<http://www.gao.gov/new.items/d021049.pdf>>

Vacante, Russell A. "Performance Based Contracting an Acquisition Strategy for the 21<sup>st</sup> Century." Army Management Staff College.

## **APPENDIX A**

### **BIBLIOGRAPHY**

Vinson, Elisa. "Governing-for-Results and Accountability: Performance Contracting in Six State Human Services Agencies." The Urban Institute. (1999)

Wong, Kwan. "Performance Based Contracting: From Theory to Practice." (2001)  
<http://worforce-excellence.net/html/journey/2001/workshops/contracting.ppt>

## APPENDIX B SURVEY RESPONSES

Question	Arizona	Illinois	Minnesota	Wisconsin
When did the department start to use PBC?	1995	1997	1997	2000
Why did the agency change to PBC?	<p>The transitioning to this method started as a pilot program to change from purchasing staff to purchasing a product or deliverable. ADES was reimbursing contractors for actual cost incurred in the delivery of services, however, there was no measurable results or outcomes at the end of the contract term.</p> <p>An example is ADES would reimburse contractors for staff to recruit, license and supervise foster homes. One of the objectives of the service was to increase the number of licensed foster homes each year. The contractor would receive payment for their actual cost (Personnel, ERE, Space, etc) but may never recruit or license a new foster home during the contract period. Since payment was tied to actual cost, there was no incentive for the contractor to recruit and license more foster homes.</p>	<p>The agency changed to a performance based contracting to reduce the backlog of the number of children in foster care. We had 52,000 kids in care then. We now have fewer than 18,000. Before this agencies where based on the number of days in care with no incentive to move kids out of care.</p>	No Response	<p>We implemented this change in an effort to move towards outcome-based products versus activities and increased accountability. Prior to that, we required only work plans full of activities with no specific products or deliverables.</p>

## APPENDIX B SURVEY RESPONSES

Question	Arizona	Illinois	Minnesota	Wisconsin
Is performance based contracting a statewide effort or just an agency effort?	I can only respond for DES. Throughout the Department, more administrations are transitioning to performance base contracting	It is a statewide DCFS effort.	Statewide	Agency wide only
Does the agency have agency-wide performance measures that are incorporated in the contracts?	No Response	Yes	No, we have scores of programs, each with differing requirements, so we can't have universal performance measures.	We contract for measurable objectives with specific deliverables that are tied to local health plans, our state health plan, and federal Healthy People 2010. We also have minimum criteria (infrastructure) that must be in place in order for an agency to accept funds.
What has been the impact of performance based contracting?	Increase in accountability of service delivery and deliverables. Also there has developed a partnership between the contract community and the State's social service agency.	The impact of performance based contracting has been dramatic reductions in the number of children in substitute care and shorter lengths of stay.	We have not conducted an agency-wide evaluation of performance-based contracting versus non-performance based contracting, so there is no hard data on which to base an answer to this question. However, for each performance-based contract, there are quantifiable objectives that have been met.	A very mixed bag of results. Some view it as positive, others negative. We now have specific products that we are able to identify versus activities that don't show results. Some of the concepts were controversial – like recoupment for non-performance.
How is performance defined? Is it output, effectiveness, or efficiency measures?	Depending on the service, it may be a deliverable/output or a milestone in a case.	Performance was just based on permanency outputs. It is now based on output, effectiveness, and efficiency.	Could be any or all of the them.	Output and outcomes.



## APPENDIX B SURVEY RESPONSES

Question	Arizona	Illinois	Minnesota	Wisconsin
Are performance based contracts used for all contracts, certain types of services, or at the discretion of the contracting agency?	<p>The Department is expanding the use of performance base contracts throughout the various divisions within DES. The Division of Children, Youth and Families has the developed services based on deliverables and payments tied to achievements within a case. Other Divisions have incorporated this technique in their contracts, such as the Rehabilitation Service Administration changing their major employment service program to performance base using milestones within the case as the performance measure</p> <p>The Department is expanding the use of performance base contracts throughout the various divisions within DES. The Division of Children, Youth and Families has the developed services based on deliverables and payments tied to achievements within a case. Other Divisions have incorporated this technique in their contracts, such as the Rehabilitation Service Administration changing their major employment service program to performance base using milestones within the case as the performance measure</p>	Performance based contracts are currently only being used in Foster care.	Applies to all contracts.	Only for certain public health programs – those that are statewide in nature, meaning have funding for every local health department plus a few select others.

## APPENDIX B SURVEY RESPONSES

Question	Arizona	Illinois	Minnesota	Wisconsin
What were the critical processes or issues that made for successful implementation of your performance based contracting?	<p><i>In order for a successful transition, DES found it was critical to hold partnering meetings with the vendor community. The vendor community involvement from the initial concept to the identification of the performance measures is critical for the implementation to work.</i></p> <p>After contracts were awarded, regularly scheduled meetings with all contractors for the service were essential in order for the transition to work. At these meeting issues such as cash flow, reasonableness of the negotiated rate, DES staff expectations versus prescriptive contracts and conflict resolution issues were discussed.</p> <p>The most important lessons learned were:</p> <ul style="list-style-type: none"> <li>• involve the vendor community in the process,</li> <li>• identify and discuss risks; and</li> <li>• change is necessary for both parties.</li> </ul>	Strong public/private agency collaboration and agreements to reinvest some savings back into the system.	Formal contract review and approval process located in one division; staff training.	The most critical elements were input from contractors, intensive training efforts and open communication.

## APPENDIX B SURVEY RESPONSES

Question	Arizona	Illinois	Minnesota	Wisconsin
What were the primary problems in implementing performance based contracting? Staff training, identification of performance measures, vendor resistance, etc. What did you do to resolve the problems?	<ul style="list-style-type: none"> <li>• Change over from budget based contracts to rate base with deliverables or outcomes as the trigger to payments</li> <li>• Cash flow issues for the vendors – Payments are based on a deliverable – outcome which may delay the cash flow initially. Base payments on milestones versus final result</li> </ul>	There needed to be a vehicle for vendors to be able to resolve issues that arose. A committee was formed by the state where that meets year round to resolve these issues. 3 major things needed to happen for us, there needed to be vendor by in which was facilitated by the committee. Setting the stage – state agencies needed to do what they should be doing because there are certain elements of the process that the vendors have no control over. Data – Needs to be a data driven process, without proper data performance monitoring will not occur.	Defining and identifying performance measures; staff training. Began legal review and approval process for all contracts; provided staff training.	Getting people to switch their mind frame from activities to outcomes was the most challenging aspect for us. Also, training on how to write measurable objectives.
How well was the change accepted by the vendors and agency staff?	Initially vendors had a difficult time with the change. Now they understand they have more flexibility in the service delivery and how they can use the money received from the rate (budget limited where money could be spent)	Because vendors where giving a chance to have input in the implementation it was widely accepted.	Vendors are fine; agency staff are still sometimes resistant.	A lot of uncertainty at first – but widely accepted now.
What happens if a contractor does not meet the performance criteria in the contract?	Other than a contract non-compliance letter for service delivery, that is all. There is no penalty payment in the contracts	The agency is put on intake hold. This results in the agency losing contract size in the next fiscal year.	Contractors who do not perform satisfactorily receive reduced payments, and/or are subject to termination.	Funds are recouped (taken back).

## APPENDIX B SURVEY RESPONSES

Question	Arizona	Illinois	Minnesota	Wisconsin
Is the performance criteria also part of the selection criteria?	Contractors past performance may be used as part of the evaluation criteria in evaluating proposals.	No Response	All solicitation documents contain a description of services to be performed and/or deliverables to be provided; these same services/deliverables are used to determine whether the contractor's performance was adequate.	No
What areas still need improvement and what actions are you taking to maintain and improve performance based contracting?	<ul style="list-style-type: none"> <li>• Continual meetings with the vendor community through Request for Information meetings for new or revised services</li> <li>• Regular meetings with contractors to discuss service delivery and achievement of outcome goals</li> </ul>	We are shifting the focus to address practice and service delivery issues. The areas we are trying to improve are those needing improvement identified in our Child and Family Services Review.	We continue to train staff on the importance of including measurable outcomes in both the solicitation document and the contract itself. We continue to train staff on contract management, and keeping contractors at arms-length	Looking at different ways to deal with performance since recoupement is so controversial.

## APPENDIX B SURVEY RESPONSES

Question	San Diego County	New York City
When did the department start to use PBC?	1998	Late 1990s
Why did the agency change to PBC?	No Response	Although contractor performance was evaluated based on performance standards set forth in the contract, payment was not directly linked to such performance. (i.e., there were no financial disincentive or incentives).
Is performance based contracting a statewide effort or just an agency effort?	No Response	PBC is encouraged where appropriate. There are some typed contracts for which a fully PBC is not appropriate, such as senior centers. In those cases, the payment structure is based on a combination of line-item reimbursement for PS and OTPS expenses; however, the contractor is paid only for the units of service of a particular item actually provided (e.g., meal).
Does the agency have agency-wide performance measures that are incorporated in the contracts?	Performance measures that support the overall Agency-wide measures are developed uniquely for each program/contract effort as appropriate	All contracts require that the contractor comply with applicable performance standards.
What has been the impact of performance based contracting?	We have moved about 20 percent of contracts from Cost Reimbursement to Performance Based, this represents about 60, valued at several millions of dollars.	PBC has increased quantity and quality of output from contractors. It is also good for agencies not only for revenue/productivity; it helps give new light to the basis on which contractor performance should be appropriately measured, even when such performance is not related to money.
How is performance defined? Is it output, effectiveness, or efficiency measures?	It varies by service type, but it is usually an outcome (such as getting a welfare recipient a job) or at least an event that generally predicts and outcome. Example acquiring a GED. This is not self sufficiency but is a recognized step in that direction.	Performance is a combination of output, effectiveness and efficiency measures.

## APPENDIX B SURVEY RESPONSES

Question	San Diego County	New York City
Are performance based contracts used for all contracts, certain types of services, or at the discretion of the contracting agency?	It is at the discretion of the division or agency, with their clear understanding that Performance Based is the preference and is our policy. However some services may have funding restrictions which require cost reimbursement, or they are in the final year of a multiple year cycle or the services may be new and unpredictable.	Performance contracts are used only where appropriate. While strongly encouraged, it is at the discretion of the agency.
What were the critical processes or issues that made for successful implementation of your performance based contracting?	Staff Training, Contractor Training and willingness to accept new contracting method	NYC contracts with a very wide range of not-for-profits, from large entities with annual budgets in excess of a hundred million dollars, who serve thousands of clients throughout the year, to small neighborhood-based groups with a couple of staff people who run an arts and crafts program serving a few dozen kids during the summer. Indeed, there are agency programs that select vendors of both types to provide services under the same overall program. But one size does not necessarily fit all from the standpoint of PBC accountability. A key issue in determining success (or in identifying sources of resistance) is whether the provider community has the capacity -- e.g., sophisticated accounting systems, automated client tracking systems, etc. -- to document results and succeed with a PBC contract. Even larger organizations sometimes have difficulty in this environment when it results in significant cash flow issues, as many of these groups are very thinly capitalized and have few reserves.

## APPENDIX B SURVEY RESPONSES

Question	San Diego County	New York City
What were the primary problems in implementing performance based contracting? Staff training, identification of performance measures, vendor resistance, etc. What did you do to resolve the problems?	No Response	While our record is improving, the City has had difficulty for years managing to complete contract processing on time each year, so that new contracts can be registered (available for payment) at or before the old ones run out. The consequence of these delays in processing is that many client services programs are forced to wait months at the beginning of each new contract cycle before they can receive payment. When payment must also await documentation of specific performance goals, some of which by definition require that substantial services be rendered before the milestones are achieved, the resulting cash flow strains can be self-defeating to the City's overall goal of encouraging high quality performance.
How well was the change accepted by the vendors and agency staff?	Mixed reactions, however, positive overall.	It was a learning process over time for both the City agencies and the vendor community, in particular human services vendors who had historically be paid exclusively based on line-item budget reimbursement.
What happens if a contractor does not meet the performance criteria in the contract?	Did not receive payments for paypoints. Other options include requiring contractor to submit performance improvement plans, contract termination, and or re-competition.	It depends on the parameters of PBC written into the contract (e.g., imposition of liquidated damages; reduction in contracted fee/service; et. al.) In addition, the agency may request a corrective action plan from the contractor and or may take no action to renew the contract, if applicable.

## APPENDIX B SURVEY RESPONSES

Question	San Diego County	New York City
Is the performance criteria also part of the selection criteria?	No response	Selection criteria, which are in general - quantity and quality of successful relevant experience, organizational capability and quality of the proposed technical approach - are separate from performance criteria. However, for a contract that will be 100% performance based a proposer may be requested to demonstrate their successful experience in performing on a 100% PBC contract and to demonstrate their financial capability to work under such a payment structure.
What areas still need improvement and what actions are you taking to maintain and improve performance based contracting?	Education of techniques and application to more programs	



